

M e m o r a n d u m**190.1883**

To: Santa Ana – Auditing (WMM)

March 31, 1971

From: Tax Counsel (JM) - Headquarters

Subject: P--- A--- Corporation

SR -- XX XXXXXX

In your memorandum of March 9, 1971 you ask our opinion as to the proper application of tax to installed communication equipment under the following circumstances.

We understand that P--- A--- Corporation purchases and installs communication equipment in existing buildings. The equipment consists of a central exchange, touch dial communicators, and head sets. The transactions are considered by P--- as contracts for improvements to real property performed for building operators or occupants or for leasing companies who lease the equipment to the building owners or occupants.

The method of taxpayer's operation follows the established pattern of:

1. Taxpayer locates a customer who owns or occupies a commercial building.
2. The communication system is installed and upon acceptance by the customer he is given a choice of purchasing or having taxpayer arrange for him to lease from a separate leasing company.
 - (a) If the customer decides to purchase, payment is made within 10 days and the taxpayer regards the transaction as a contract for improvement to realty and reports in conformance with ruling 11.
 - (b) If the customer decides to lease, taxpayer locates a leasing company and executes a sales invoice showing the leasing company as the buyer. In reporting, taxpayer also regards this transaction as a contract for improvement to realty and reports as a consuming contractor under ruling 11.

Your audit problem has centered around the sales to the leasing companies where taxpayer bills the leasing company on a lump-sum basis with a parenthetical notation that, sales tax, delivery, and installation are included (Exhibit B, attached to your memorandum). Resale certificates have not been rendered by the leasing companies. In fact some of the leasing companies do not hold seller's permits. You state that since the taxpayer is the retailer of fixtures, and the sales invoice shows sales tax to be included in the lump-sum amount charged

are the rental receipts by the leasing companies exempt from tax under section 6006(b)(5)? If so, is the taxpayer as the retailer of the communication system responsible for payment of sales tax in excess of the amount computed on the cost of the fixtures under ruling 11?

We have taken the position that communication systems constitute improvements to realty with the components of the affixed system classified as fixtures. We assume that the system involved here qualifies.

While the documents attached as exhibits to your memorandum do not cast the transactions in the normal form of a construction contract, we believe they are, in substance, construction contracts. Essentially, they provide for the furnishing and installation of the communications system for a lump-sum price. The reservation of title by the seller-contractor as security for payment of the contract price does not change the classification from real to personal property for purposes of ruling 11.

Under the circumstances of the instant case we have decided to take the position that where the contractor “sells” the fixtures to the leasing company (which is not also the lessor of the realty) we will consider that if the contractor has properly reported the tax on the fixtures in accordance with ruling 11, the property will be regarded as tax paid in the hands of the lessor. Accordingly,, the rental receipts from the lease would not be subject to the tax.

If the contractor has not properly reported the tax under ruling 11, liability for any additional tax will be that of the contractor.

The lessor may give the contractor a resale certificate for the property to be leased and elect to pay tax on his rental receipts, in which case the contractor would be permitted to regard his “sale” of the fixtures as an exempt sale for resale.

In arriving at our determination of the application of the tax to the “sale” of the fixtures in the above case, we have take a different approach than that applicable to buildings and structures as provided in annotation 1535.27. We believe that the circumstances of the use of “materials” and the existence of fabrication labor in the construction of a building or structure, and the lack of those elements in the present case justifies a distinction.

Further, it is contemplated that annotation 1535.27 will be modified by the proposed regulation 1660.

JM:smb

cc: San Bernardino – Dist. Admin.
Mr. S. Taylor – Hollywood – Subdist. Admin.
Mr. R. Nunes